

ST 02-10

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS**

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS)	
)	Docket No. 00-ST-0000
v.)	IBT # 0000-0000
)	NPL # 0000
JOHN DOE)	
)	
Respondent)	

RECOMMENDATION FOR DISPOSITION

Appearances: Kent Steinkamp, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Randall A. Wolter of Wolter, Beeman & Lynch for John Doe.

Synopsis:

The Department of Revenue ("Department") issued a Notice of Penalty Liability ("NPL") to John Doe ("respondent") pursuant to section 3-7 of the Uniform Penalty and Interest Act ("UPIA") (35 ILCS 735/3-7). The NPL alleges that the respondent was an officer or employee of ABC Management, LLC ("corporation") who was responsible for willfully failing to pay the corporation's retailers' occupation taxes ("ROT"). The respondent timely protested the NPL, and an evidentiary hearing was held. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

1. The corporation was started in 1994 for the purpose of operating five XYZ restaurants. (Tr. pp. 8-9)

2. Approximately three months after the corporation purchased the restaurants, the respondent became aware that the restaurants were not making a profit. (Tr. pp. 18-19)

3. The respondent was a shareholder of the corporation and owned approximately twelve percent of the shares. He did not receive any income or dividends from the corporation. (Tr. p. 9)

4. The largest shareholder owned approximately 17% of the shares of the corporation. The respondent's share of the company was the second largest, and two other shareholders owned percentages equal to the respondent's share. The remaining shareholders each owned approximately 2 to 4 percent of the shares. (Tr. pp. 16-18)

5. The respondent was one of three people responsible for hiring the first manager for the business. The respondent interviewed the manager before he was hired and had the authority to reject the manager if the respondent decided that he was unacceptable. (Tr. pp. 20-21)

6. The respondent participated in the decision-making process for the business and helped to determine ways to improve the business. (Tr. pp. 21-22)

7. The respondent had signature authority on some of the corporation's bank accounts. (Tr. pp. 25-26)

8. The respondent signed the corporation's Sales and Use Tax Return for October 1996. (Dept. Ex. #2)

9. During September and October of 1996, the corporation made several payments to creditors other than the Department. During this time period, the corporation paid nearly \$45,000 to various creditors, such as utility companies, an insurance company, an accounting firm, suppliers, and a pest control company. (Respondent's Ex. #1, 2; Tr. p. 10)

10. The corporation continued to issue payroll checks to its employees through November 1, 1996. (Respondent's Ex. #3)

11. The corporation stopped operating the restaurants near the end of October of 1996 because the corporation was losing money and the lease for the business was terminating. The owners of the corporation expected to buy the leased property at the end of the lease, but the owner of the property refused to sell it. (Tr. pp. 12, 25)

12. On April 23, 1997, the Department issued NPL number 6529 to the respondent that proposed a total penalty liability of \$30,666.75, including tax, interest, and penalty, for failure to pay ROT for the following months: August, September, and October of 1996. The NPL was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1).

Conclusions of Law:

Section 3-7 of the Uniform Penalty and Interest Act provides in part as follows:

"Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who wilfully fails to file the return or make the payment to the Department or wilfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon;" (35 ILCS 735/3-7(a)).

An officer or employee of a corporation may therefore be personally liable for the corporation's taxes if (1) the individual had the control, supervision or responsibility of filing the ROT returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

Under section 3-7, the Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due.¹ See Branson

¹ The relevant portion of section 3-7 provides as follows: "The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section. Proof of that determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy or computer printout of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. * * * That certified reproduced copy or certified computer print-out shall without further proof, be admitted into evidence before the

v. Department of Revenue, 168 Ill.2d 247, 260 (1995). Once the Department presents its *prima facie* case, the burden shifts to the respondent to establish that one or more of the elements of the penalty are lacking, i.e., that the person charged was not the responsible corporate officer or employee, or that the person's actions were not wilful. *Id.* at 261. In order to overcome the Department's *prima facie* case, the allegedly responsible person must present more than his or her testimony denying the accuracy of the Department's assessment. A. R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826, 833-34 (1st Dist. 1988). The person must present evidence that is consistent, probable, and identified with the respondent's books and records to support the claim. *Id.*

In the present case, the Department's *prima facie* case was established when the Department's certified record relating to the penalty liability was admitted into evidence. In response, the respondent first contends that he did not have the control, supervision, or responsibility for filing the returns.

The respondent claims that in cases where a party was found to be responsible for filing the returns, such as Branson, the party had a much greater role in the operation of the business than the respondent had in this case. The respondent argues that he was not involved in the day-to-day activities of the company. The respondent had a full-time job in the banking and real estate industries while he was an owner of the corporation. He was only a 12.5% shareholder and did not receive income from the business. The respondent argues that he was not involved in preparing the returns and did not sign any of the corporate checks. The respondent claims that there is no evidence in the record that he ever indicated that he was responsible for paying the taxes. On the Illinois Business Registration form filed by the corporation, Form NUC-1, Jane Doe accepted personal responsibility for filing the returns and paying the taxes. (Dept. Ex. #3)

Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax or penalty due." 35 ILCS 735/3-7(a).

The Department's initial argument is that the respondent has failed to present sufficient evidence to overcome the Department's *prima facie* case. The Department notes that the respondent introduced three exhibits, which consisted of copies of checks written from the corporation's accounts. The exhibits included checks that were mostly written during August, September, and October of 1996, but not all of the checks that were written during that time period were included. The Department states that the only other evidence submitted by the respondent was his own self-serving testimony. The Department contends that the respondent has failed to present evidence supported by the corporation's books and records that indicates that the Department's determination is incorrect.

The Department also argues that the respondent cannot avoid responsibility on the basis that an outside accounting firm prepared the returns, which were then signed by the corporation's manager. The Department contends that in Estate of Wayne Young v. Department of Revenue, 316 Ill.App.3d 366 (2000), the court found that an officer's general knowledge of the financial condition of the business was sufficient to establish the necessary responsibility even though the officer never looked at the corporation's books. The Department argues that in the present case, the respondent knew that bills were not being paid at the time that the ROT was not remitted to the Department. He regularly examined the corporation's books and attended meetings to discuss the business operations. The Department claims that the evidence indicates that the respondent was very involved in the business and should be found responsible.

For guidance in determining whether a person is responsible under section 3-7 the Illinois Supreme Court has referred to cases interpreting section 6672 of the Internal Revenue Code (26 U.S.C. §6672)². See Branson at 254-56; Department of Revenue v. Heartland Investments, Inc., 106 Ill.2d 19, 29-30 (1985). These cases state that the

² This section imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes.

critical factor in determining responsibility is whether the person had significant control over the corporation's finances. See Purdy Co. of Illinois v. United States, 814 F.2d 1183, 1186 (7th Cir. 1987). Responsibility is generally found in high corporate officials who have control over the corporation's business affairs and who participate in decisions concerning the payment of creditors and the dispersal of funds. Monday v. United States, 421 F.2d 1210, 1214-1215 (7th Cir. 1970), cert. den. 400 U.S. 821. Some of the factors that courts have considered in determining responsibility include whether the person: (1) is an officer or member of the board of directors; (2) owns shares or possesses an entrepreneurial stake in the company; (3) is active in the management of day-to-day affairs of the company; (4) has the ability to hire and fire employees; (5) makes decisions regarding which, when and in what order outstanding debts or taxes will be paid; (6) exercises control over daily bank accounts and disbursement records; and (7) has check-signing authority. Fiataruolo v. United States, 8 F.3d 930, 939 (2nd Cir. 1993).

In the present case, the respondent failed to submit sufficient evidence to overcome the Department's *prima facie* case. To overcome the Department's *prima facie* case, the respondent must present evidence that he lacked actual authority to act on the corporation's behalf. Notwithstanding the respondent's own testimony denying responsibility, the evidence supports a contrary finding. Although the respondent did not sign any of the checks that he submitted into evidence, the respondent admitted that he did not present all of the checks that were in his possession. (Tr. pp. 13-14) He testified that he had the authority to sign checks, and he did sign one of the tax returns. He stated that "[t]he three of us that were on the corporation forms" hired the manager for the business. (Tr. p. 20) The respondent said that he had the authority to reject the manager if he thought he should not have been hired. (Tr. p. 21) Approximately three months after the corporation began, the respondent became aware that the restaurants were not making a profit. (Tr. pp. 18-19) The respondent was able to access the corporation's books and records at any time (Tr. p. 21), and he participated in meetings concerning how

to improve the business. (Tr. p. 22) In order to prevail in this case, it was incumbent upon the respondent to present evidence other than his own testimony showing that he did not have significant control over the corporation's finances. The respondent has failed to meet this burden.

In addition, the respondent failed to present evidence that he did not willfully fail to pay the taxes. Case law defines "wilfull" as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious known risks. See Branson at 254-56; Heartland at 29-30. Wilfull conduct does not require bad purpose or intent to defraud the government. Branson at 255; Heartland at 30. Willfulness may be established by showing that the responsible person (1) clearly ought to have known that (2) there was a grave risk that the taxes were not being paid and (3) the person was in a position to find out for certain very easily. Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987). Furthermore, whether the person in question wilfully failed to pay the taxes is an issue of fact to be determined on the basis of the evidence in each particular case. Heartland at 30; Department of Revenue v. Joseph Publick & Sons, Inc., 68 Ill.2d 568, 577 (1977). Courts have found that giving preferential treatment to other creditors rather than paying the corporation's taxes constitutes wilfull behavior. See Heartland at 29-30.

In light of the following facts, the respondent's testimony that he did not know that other creditors were being paid instead of the Department was not credible. The respondent worked in the banking and real estate industries and was therefore experienced in business. He admitted that he knew the corporation was having financial problems, he had access to the books, and he participated in discussions concerning the business operations. The respondent testified that the only reason the sales taxes were not paid was because there were no funds to pay them (Tr. p. 15); the respondent submitted several checks, however, indicating that the corporation paid nearly \$45,000 to creditors other than the Department during September and October of 1996. From the

evidence presented, it is reasonable to conclude that the respondent should have been aware that the taxes were not getting paid. The fact that other creditors were being paid during the periods at issue supports a finding that he wilfully failed to pay the taxes.

Recommendation

It is therefore recommended that the Notice of Penalty Liability be upheld.

Linda Olivero
Administrative Law Judge

Enter: February 25, 2002